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No. 79-1266

IN THE
Supreme Court of the United States
OCTOBER TERM, 1980

CHARLES W. STEADMAN,
Petitioner,

v.

SECURITIES AND EXCHANGE COMMISSION,
Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

BRIEF FOR SECURITIES INDUSTRY ASSOCIATION AS *AMICUS CURIAE*

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QUESTIONS PRESENTED

1. Whether, in disciplinary proceedings before the Securities and Exchange Commission, which frequently result in permanent exclusion from the securities industry as well as other harsh sanctions, willful violations of anti-fraud provisions of the federal securities laws must be proved by clear and convincing evidence, rather than by a mere preponderance of the evidence.

2. Whether the Administrative Procedure Act requirement that the Securities and Exchange Commission justify with particularity the sanctions it imposes is an adequate substitute for clear and convincing evidence to support a Commission finding of willful securities fraud violations.

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INTEREST OF THE SIA AS *AMICUS CURIAE*[1]

The Securities Industry Association ("SIA") is a national trade association representing approximately 500 brokers and dealers responsible for over 90 percent of the securities brokerage and investment banking business of the nation. Its membership is located throughout the United States and represents a broad cross section of the securities industry, including members of every national securities exchange as well as securities firms not members of the exchanges.

SIA's members perform a complete spectrum of professional securities activities, including retail and institutional brokerage, over-the-counter market-making, underwriting and other investment banking activities, various exchange floor functions, money management and investment advisory services with respect to corporate, municipal, government, and foreign securities. The SIA is generally recognized as a principal spokesman for the securities industry before legislative, regulatory, and judicial bodies.

The issue of the quantity of evidence required to sustain a Securities and Exchange Commission ("SEC" or "Commission") disciplinary order against one of the broad range of professionals in the securities industry is of utmost importance to the SIA and its members. The SIA cooperates with the SEC, the stock exchanges, and other self-regulatory organizations in sponsoring numerous programs to educate its members and others with respect to compliance with the applicable securities laws. Nevertheless, given the complexities of the securities laws, disputes over the propriety of conduct by securities

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[1] All parties have consented to the filing of this brief for *amicus curiae* in support of Petitioner. *See* letter from the Solicitor General to Counsel for SIA, dated May 23, 1980, and letter from Counsel for Steadman to Counsel for SIA, dated June 5, 1980, copies of which have been filed with the Clerk of this Court.

professionals will arise. In the adjudication of such disputes, based as they frequently are on broad, vague statutory anti-fraud provisions, there is a higher than normal risk of an erroneous result. The standard of proof in SEC disciplinary proceedings determines the extent to which industry professionals must bear that risk. The SIA believes that the SEC's application of the clear and convincing evidence requirement in its disciplinary proceedings since the decision in *Collins Securities Corp.* v. *SEC*, 562 F.2d 820 (D.C. Cir. 1977), has added substantially to the fairness of such proceedings and the resulting sanctions. Consequently, the SIA urges this Court to reverse the Court of Appeals' conflicting decision in this case because that decision, if allowed to stand, will increase the risk of unfair disciplinary proceedings with unwarranted sanctions and thus undermine public confidence in the justice of such proceedings.

STATEMENT

Petitioner Charles W. Steadman is president, chairman of the board, and sole beneficial owner of all the voting stock of Steadman Security Corporation ("SSC"), a registered investment adviser. SSC, either directly or through wholly owned subsidiaries, advises and manages several mutual funds known collectively as the Steadman Funds. In June 1971, the SEC instituted an administrative disciplinary proceeding against Steadman, SSC, and the subsidiaries, alleging willful violations of several provisions of the federal securities laws.

Over petitioner's objection that a more rigorous standard of proof was required,[2] the SEC found, by a mere preponderance of the evidence, that petitioner and SSC had willfully violated or aided and abetted violations of the anti-fraud provisions of Section 17(a) of the Se-

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[2] *Steadman Security Corp.*, [1977-78 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 81,243 at 88,339-19 n.88 (June 29, 1977).

curities Act of 1933, Section 10(b) of the Securities Exchange Act of 1934, and Rule 10b-5 thereunder, and Sections 206(1) and (2) of the Investment Advisers Act of 1940. On the basis of these findings, the SEC (1) permanently barred Steadman from associating with any investment adviser, (2) prohibited him from affiliating with any registered investment company, and (3) suspended him for one year from associating with any broker or dealer.[3]

Upon review, the United States Court of Appeals for the Fifth Circuit held that a mere preponderance of the evidence was sufficient to sustain the SEC's findings of willful fraud violations.[4] However, noting that the SEC had imposed the most severe sanctions at its disposal, the Fifth Circuit remanded with directions that the Commission "articulate a sufficient justification" for ordering petitioner's expulsion from the industry.

SUMMARY OF ARGUMENT

The SEC asks this Court to reinstate the pre-*Collins* standard to permit the SEC to bar permanently broker-dealers, investment advisers, underwriters and other securities industry personnel from their chosen professions, although the SEC is unable to find clear and convincing evidence that the professional respondent willfully violated anti-fraud provisions of the federal securities laws.

As this Court has repeatedly recognized, any adjudication of fact can be erroneous, and the function of the standard of proof is to allocate the risk of an erroneous result between the government and the target of government disciplinary action. The preponderance of the evidence—or more likely than not—standard, applied by the SEC and affirmed below, improperly places upon industry

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[3] *Id.* at 88,339-23.

[4] *Steadman* v. *SEC*, 603 F.2d 1126 (5th Cir. 1979).

professionals substantial and unwarranted risks of erroneous adjudication of willful fraud and the unfair imposition of harsh sanctions.

A clear and convincing evidence standard is appropriate because SEC disciplinary proceedings are penal or quasi-criminal in nature. The possible sanctions, including license revocation, suspension and permanent bar from the securities industry, constitute harsh penalties that are analogous to disbarment of a lawyer. In addition, these disciplinary proceedings almost always involve ambiguous or inferential evidence and the "willful fraud" stigma that have traditionally led courts, including this one, to require clear and convincing proof.

The court below, applying settled principles of judicial administration, properly required the SEC to justify with particularity the sanctions imposed. Justifying the severity of the particular sanction imposed does not, however, eliminate the need for clear and convincing proof of a willful fraud violation. Application of an erroneous standard of proof in making the underlying finding of a willful violation of the anti-fraud provisions will undermine the fairness of the proceeding regardless of the sanction. Exclusive reliance on judicial review of the sanction would also enable the SEC to extract settlements from persons who would not otherwise be charged. Because judicial review of the choice of sanction is traditionally narrow, it is not a substitute for the correct standard of proof of a willful violation.

ARGUMENT

The SEC conducts administrative disciplinary proceedings pursuant to several statutes and its own rules of practice.[5] It has broad powers to impose severe sanc-

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[5] *See, e.g.*, §§ 8(d) and (e) of the Securities Act of 1933, 15 U.S.C. § 77(d) and (e) (1976); §§ 15(b)(4) and (6), 15(c)(4), 15A and 19(h) of the Securities Exchange Act of 1934, 15 U.S.C. § 78o(b)(4) and (6), § 78o(c)(4) (1976), 15 U.S.C.

tions. The SEC can permanently bar a person from being registered as, or associated with, a broker, dealer, investment adviser, or investment company upon a finding that the person has willfully violated, or willfully aided and abetted violations of, the federal securities laws, or willfully made false or misleading statements in reports filed with the SEC. Although lacking express statutory authority, the SEC also claims and frequently exercises the power to bar from practice before it lawyers,[6] accountants,[7] and other professionals whom it finds to have willfully violated, or willfully aided and abetted others in violating, the federal securities laws.

Neither statute nor SEC rule specifies the standard of proof necessary in such proceedings, that issue being left for resolution through case law development.[8] Before

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§ 78o-3, s(h) (1976); § 203(e) of the Investment Advisers Act of 1940, 15 U.S.C. § 80b-3 (1976); and §§ 8, 9, and 41 of the Investment Company Act of 1940, 15 U.S.C. §§ 80a-8, 80a-9, 80a-41 (1976); 17 C.F.R. § 201.2(e) (1979); *see also* 3 L. Loss, Securities Regulation 1891-1944 (2d ed. 1961); 6 L. Loss, Securities Regulation 4020-4078 (2d ed. Supp. 1969); Mathews, *Litigation and Settlement of SEC Administrative Enforcement Proceedings*, 29 Cath. U.L. Rev. 215, 220-26 (1980).

[6] *See, e.g., Kivitz* v. *SEC*, 475 F.2d 956 (D.C. Cir. 1973), *rev'g Murray A. Kivitz*, 44 S.E.C. 600 (1971); *Schwebel* v. *Orrick*, 153 F. Supp. 701 (D.D.C. 1957), *aff'd*, 251 F.2d 919 (D.C. Cir.), *cert. denied*, 356 U.S. 927 (1958); *Morris Mac Schwebel*, 40 S.E.C. 347 (1960); *Keating, Muething & Klekamp*, [1979 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 82,124 (July 2, 1979) (particularly dissenting opinion of SEC Commissioner Karmel); *William R. Carter*, [1979 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 82,175 (March 7, 1979) (initial decision), *appeal pending before SEC*.

[7] *See, e.g., Touche Ross & Co.* v. *SEC*, 609 F.2d 570 (2d Cir. 1979).

[8] *See, e.g., Woodby* v. *INS*, 385 U.S. 276, 284 (1966) (The appropriate standard of proof "is the kind of question which has traditionally been left to the judiciary to resolve. . . .").

the decision in *Collins* v. *SEC*, 562 F.2d 820 (D.C. Cir. 1977) [hereinafter cited as *Collins*], the SEC applied the mere preponderance or "more likely than not" standard in its disciplinary proceedings. It did so even when the respondent was charged with willful violations of the anti-fraud provisions of the federal securities laws and faced the possible sanction of permanent exclusion from his chosen profession.[9]

In affirming the SEC's use of the "more likely than not" standard, the Fifth Circuit expressly declined to follow the *Collins* decision, in which Judge Wilkey, joined by Judges Leventhal and Wright, held that "a realistic correlation between the burden of persuasion and the available remedies" required application of the "clear and convincing" standard in SEC disciplinary proceedings involving allegations of willful fraud and the potential for serious sanctions.[10] The Fifth Circuit failed to acknowl-

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[9] *See Harold T. White*, 3 S.E.C. 466, 539-40 (1938), where the Commission adopted the mere preponderance standard even though it held its administrative disciplinary proceedings were "closely analagous to proceedings for the collection of a statutory penalty." *See also Steadman Security Corp.*, [1977 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 81,243 at 88,339-19 n.88 (June 29, 1977); *Norman Pollisky*, 43 S.E.C. 458, 459-60 (1967); *James De Mammos*, 43 S.E.C. 333, 337 (1967), *aff'd mem.* (2d Cir., Oct. 13, 1967); *Harris Clare & Co.*, 43 S.E.C. 198 (1966); *Underhill Securities Corp.*, 42 S.E.C. 689 (1965); *Richard N. Cea*, 44 S.E.C. 8, 25 (1969); *Associated Sec. Corp.* v. *SEC*, 283 F.2d 773 (10th Cir. 1960); *Pierce* v. *SEC*, 239 F.2d 160 (9th Cir. 1956); *Wright* v. *SEC*, 112 F.2d 89 (2d Cir. 1940); *Abbett, Summer & Co.*, 44 S.E.C. 104 (1969), *aff'd sub nom. Abbett, Summer & Co.* v. *SEC*, [1970-71 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 92,813 (D.C. Cir. 1970) (*per curiam*), *cert. denied*, 401 U.S. 974 (1971); *Aircraft Dynamics Int'l Corp.*, 41 S.E.C. 566 (1963); *MacRobbins & Co.*, 40 S.E.C. 497, *remanded on other grounds sub nom. Berko* v. *SEC*, 297 F.2d 116 (2d Cir. 1961).

[10] 562 F.2d at 826.

edge that in *Whitney* v. *SEC*, 604 F.2d 676 (D.C. Cir. 1979), the District of Columbia Circuit had reaffirmed and extended *Collins*, holding that "any sanction imposed under section 15(b) [of the Securities Exchange Act of 1934] which depends on a finding of fraud must be sustained by clear and convincing evidence." [11] In addition, the Fifth Circuit apparently gave no weight to the SEC's application of the clear and convincing standard in a number of post-*Collins* administrative disciplinary proceedings involving brokers,[12] investment advisers,[13] and lawyers.[14] Nor did the Fifth Circuit note that other administrative agencies, relying on the reasoning in *Collins*, have applied the clear and convincing standard in disciplinary proceedings.[15] After the *Steadman* decision, the

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[11] 604 F.2d at 681 (footnote omitted). The *Whitney* court severely rebuked the SEC for taking "an overly parsimonious view of our rationale in *Collins*." *Id.*

[12] *E.g., Allen & Co.*, [1979 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 82,174 at 82,163 (Aug. 2, 1979) (initial decision); *Thomas A. Sartain*, SEC 1934 Act Release No. 16,561 (Feb. 8, 1980); *J.A.B. Sec. Co.*, SEC 1934 Act Release No. 15,948 (June 25, 1979).

[13] *E.g., Hinkle Northwest, Inc.*, SEC 1934 Act Release No. 15,338 (Nov. 16, 1978); *International Research & Management Corp.*, SEC Investment Advisers Act Release No. 617 (March 6, 1978). In each of these proceedings, the SEC declined to determine whether *Collins* governed but nevertheless found clear and convincing evidence of violations.

[14] *William R. Carter*, [1979 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 82,175 at 82,165 & n.3 (March 7, 1979) (initial decision), *appeal pending before SEC.*

[15] *See, e.g., Harold Collins*, [1977-80 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 20,910 (1979) (CFTC administrative proceeding); *Compania Salvadorena de Cafe, S.A.*, CFTC Docket No. 79-34, 518 Sec. Reg. & L. Rep. (BNA) A-16 (August 29, 1979) (CFTC administrative proceedng). *See also Delikosta* v. *Califano*, 478 F. Supp. 640, 643-44 n.4 (S.D.

District of Columbia Circuit also applied the clear and convincing standard with respect to findings of willful fraud in a broadcast license revocation proceeding before the Federal Communications Commission. *Sea Island Broadcasting Corp.* v. *FCC*, No. 76-1735 (D.C. Cir., Jan. 14, 1980).[16] The decision below thus departs from an unmistakable trend toward application of the clear and convincing standard in willful fraud cases involving potentially severe sanctions.

Respondents in SEC disciplinary proceedings are entitled to procedural fairness.[17] In the realm of fact find-

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N.Y. 1979) (HEW administrative proceedings to reopen an award of social security benefits because of alleged fraud should be governed by clear and convincing standard).

[16] In several securities disciplinary proceedings subsequent to *Collins*, parties have raised the issue of the applicable standard of proof on appeal, but the courts have declined to resolve the issue. *E.g.*, *Shultz* v. *SEC*, 614 F.2d 561, 569 n.17 (7th Cir. 1980) ("The issue of what standard we would use in a case involving fraud is not before us."); *Sartain* v. *SEC*, 601 F.2d 1366, 1371-72 (9th Cir. 1979) (court declined to resolve issue because it was not timely raised). *See also Investors Research Corp.* v. *SEC*, [1979-80 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 97,366 at 97,445 n.41 (D.C. Cir., April 29, 1980), *language modified on another point*, [Current] Fed. Sec. L. Rep. (CCH) ¶ 97,526 (D.C. Cir., June 11, 1980) (court declined to require application of clear and convincing standard in SEC proceeding involving neither fraud nor severe sanctions); *Chatham* v. *SEC*, 604 F.2d 1368 (D.C. Cir. 1978) (*per curiam*) (court declined to resolve issue because SEC's ruling was reasonable under either standard of proof); *Nassar & Co.* v. *SEC*, 566 F.2d 790, 794 n.2 (D.C. Cir. 1977) (Leventhal, J., concurring) (SEC, while maintaining that mere preponderance standard should govern, did find clear and convincing evidence).

[17] *See SEC* v. *Sloan*, 436 U.S. 103 (1978); *cf. Silver* v. *New York Stock Exchange*, 373 U.S. 341 (1963); *Intercontinental Indus., Inc.* v. *American Stock Exchange*, 452 F.2d 935 (5th Cir. 1971), *cert. denied*, 409 U.S. 842 (1972).

ing, procedural fairness encompasses both allocating the burden of proof to the proper party [18] and selecting the appropriate standard of proof to balance the risk of erroneous decisions with other societal interests in each particular type of adjudication.[19]

A standard of proof "represents an attempt to instruct the factfinder concerning the degree of confidence our society thinks he should have in the correctness of factual conclusions for a particular type of adjudication." [20] As the Court noted last term, a particular standard of proof "serves to allocate the risk of error between the litigants and to indicate the relative importance attached to the ultimate decision." [21]

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[18] *See Mathews* v. *Eldridge*, 424 U.S. 319 (1976); *Speiser* v. *Randall*, 357 U.S. 513 (1958).

[19] The precise standard of proof appropriate to a particular type of adjudication "is embodied in the Due Process Clause and in the realm of factfinding. . . ." *Addington* v. *Texas*, 441 U.S. 418, 423 (1979). Since SEC administrative disciplinary sanctions are imposed pursuant to federal statute—the federal securities laws—determination of the applicable standard of proof in this case need not rest on constitutional grounds but simply upon the judicial responsibility properly to administer litigation. *Woodby* v. *INS*, 385 U.S. 276, 284 (1966); *see also United States* v. *Fatico*, 458 F. Supp. 388, 408 (E.D.N.Y. 1978), *aff'd*, 603 F.2d 1053 (2d Cir. 1979), *cert. denied*, 100 S. Ct. 1018 (1980).

[20] *In re Winship*, 397 U.S. 358, 370 (1970) (Harlan, J., concurring).

[21] *Addington* v. *Texas*, 441 U.S. 418, 423 (1979). This Court has recognized four separate standards of proof: (1) beyond a reasonable doubt; (2) clear, unequivocal and convincing; (3) clear and convincing; and (4) mere preponderance. Beyond a reasonable doubt, the most stringent standard, applies in criminal prosecutions. *Mullaney* v. *Wilbur*, 421 U.S. 684 (1975); *In re Winship*, 397 U.S. 358 (1970); *Holt* v. *United States*, 218 U.S. 245, 254 (1910). Clear, un-

The preponderance of the evidence test advocated by the SEC allocates to the respondent in an SEC disciplinary proceeding a substantial risk—only marginally better than the flip of a coin [22]—that the government will

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equivocal and convincing, an intermediate but stringent standard, applies in extraordinary civil cases "where the various interests of society are pitted against restrictions on the liberty of the individual . . . ." *In re Ballay*, 482 F.2d 648, 662 (D.C. Cir. 1973). *E.g.*, *Woodby* v. *INS*, 385 U.S. 276 (1976) (deportation); *Chaunt* v. *United States*, 364 U.S. 350 (1960) (denaturalization); *Baumgartner* v. *United States*, 322 U.S. 665 (1944) (denaturalization); *Schneiderman* v. *United States*, 320 U.S. 118, 125, 159 (1943) (denaturalization); *Nishikawa* v. *Dulles*, 356 U.S. 129 (1958) (expatriation); *Gonzales* v. *Landon*, 350 U.S. 920 (1955) (*per curiam*) (expatriation). Clear and convincing, another intermediate but less stringent standard, has been applied in civil cases that involve significant charges that imply moral turpitude and substantial sanctions that "can engender adverse social consequences to . . . [and] have a very significant impact on the individual." *Addington* v. *Texas*, 441 U.S. 418, 425-26 (1979) (civil commitment). *See, e.g.*, *Gertz* v. *Robert Welch, Inc.*, 418 U.S. 323, 331-32 (1974) (libel); *Rosenbloom* v. *Metromedia, Inc.*, 403 U.S. 29, 50-52 (1971) (libel); *Tippett* v. *Maryland*, 436 F.2d 1153, 1165-66 (4th Cir. 1971), *cert. dismissed sub nom. Murel* v. *Baltimore City Criminal Court*, 407 U.S. 355 (1972); *cf. United States* v. *Fatico*, 458 F. Supp. 388, 404 (E.D.N.Y. 1978), *aff'd*, 603 F.2d 1053 (2d Cir. 1979), *cert. denied*, 100 S. Ct. 1018 (1980). Mere preponderance, the least stringent standard, applies to "the typical civil case involving a monetary dispute between private parties," *Addington* v. *Texas*, 441 U.S. at 423, where the courts "view it as no more serious in general for there to be an erroneous verdict in the defendant's favor than for there to be an erroneous verdict in the plaintiff's favor." *In re Winship*, 397 U.S. 358, 371-72 (1970) (Harlan, J., concurring).

[22] The "preponderance of the evidence" standard of proof "simply requires the trier of fact 'to believe that the existence of a fact is more probable than its nonexistence . . . .'" *In re*

make an erroneous finding of willful fraud and consequently impose a penalty that can be as severe as total, permanent deprivation of profession, business and livelihood. Such a distribution of the risk of erroneous adjudication is wrong. It fails to recognize the weight the law has traditionally accorded to the interests of those facing severe sanctions and to the interests of those accused of willful fraud.[23] It also fails to accord any weight to the public interest in ensuring that salutary economic activity is not inhibited by either an actual erroneous adjudication of willful fraud or the perception that such an erroneous adjudication is likely. In contrast, the clear and convincing test recognizes these interests while reconciling them with the legitimate public interest in effective enforcement of the federal securities laws against those who are convincingly shown to have committed willful fraud violations.

Winship, 397 U.S. 358, 371 (1970) (Harlan, J., concurring) (citing F. James, *Civil Procedure* 250-51 (1965)). *See also* McBaine, *Burden of Proof: Degrees of Belief*, 32 Calif. L. Rev. 242, 261 (1944); *United States* v. *Fatico*, 458 F. Supp. 388, 403 (E.D.N.Y. 1978) (in which Judge Weinstein quantifies the various standards of proof "along a continuum from low probability [50+ percent probable] to very high probability [95+ percent probable]"), *aff'd*, 603 F.2d 1053 (2d Cir. 1979), *cert. denied*, 100 S. Ct. 1018 (1980); *United States* v. *Schipani*, 289 F. Supp. 43, 56-57 (E.D.N.Y. 1968), *aff'd*, 414 F.2d 1262 (2d Cir. 1969), *cert. denied*, 397 U.S. 922 (1970).

[23] There is ample precedent for requiring clear and convincing evidence to support *either* a finding of willful fraud, *see, e.g., Lalone* v. *United States*, 164 U.S. 255, 257 (1896); *Whitney* v. *SEC*, 604 F.2d 676 (D.C. Cir. 1979), or imposition of a drastic sanction, *see, e.g., Woodby* v. *INS*, 385 U.S. 276 (1976). The fact that this case, like *Collins*, involves both allegations of willful fraud and the most severe sanctions, provides an overwhelming basis for requiring clear and convincing evidence.

I. THE INTERESTS OF RESPONDENTS IN SEC "QUASI-CRIMINAL" DISCIPLINARY PROCEEDINGS IN WHICH THEY FACE SEVERE SANCTIONS REQUIRE THE USE OF THE "CLEAR AND CONVINCING" STANDARD OF PROOF.

Historically, where an administrative or disciplinary body has sought to impose severe sanctions, this Court has as a minimum required proof of the violation by clear and convincing evidence. In *Schneiderman* v. *United States*, 320 U.S. 118 (1943), the Court held that "the clearest sort of justification" was required to support the drastic sanction of revocation of citizenship.[24] In *Gonzales* v. *Landon*, 350 U.S. 920 (1955) (*per curiam*), this Court applied the same standard in an expatriation action.[25] In *Woodby* v. *INS*, 385 U.S. 267, 282-86 (1966), the Court held that the Immigration and Naturalization Service had to have "clear, unequivocal and convincing evidence" to order deportation. Noting the "drastic deprivations" resulting from deportation, this Court rejected the government's contention that the non-criminal

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[24] 320 U.S. at 122. In *Schneiderman*, the Court drew an analogy between public land grants and the grant of citizenship to the naturalized citizen by quoting with approval language from *Johannessen* v. *United States*, 225 U.S. 227 (1912):

> [A] certificate of citizenship is "an instrument granting political privileges and open like other public grants to be revoked if and when it shall be found to have been unlawfully or fraudulently procured." . . . To set aside such a grant the evidence must be "clear, unequivocal and convincing"—"it cannot be done upon a bare preponderance of evidence which leaves the issue in doubt."

320 U.S. at 125. The case at bar similarly could be characterized as an attempt to revoke a "public grant"—*i.e.*, the grant of a license to do business in the securities industry.

[25] *See also Nishikawa* v. *Dulles*, 356 U.S. 129 (1958) (expatriation).

nature of the proceeding permitted a preponderance standard of proof "no higher . . . than applies in a negligence case." [26] The Court added that the clear, unequivocal and convincing standard "is no stranger to the civil law" and "has traditionally been imposed in cases involving allegations of civil fraud." [27]

As recently as last term, the Court in *Addington* v. *Texas*, 441 U.S. 418, 431 (1979), held that in civil commitment proceedings the states must apply at least a clear and convincing standard—a "middle level of burden of proof that strikes a fair balance between the rights of the individual and the legitimate concerns of the state."

This Court has also repeatedly recognized that administrative deprivation of a person's employment is a drastic sanction or punishment that triggers a panoply of procedural and constitutional protections. The Court has held that a person may not be deprived of his employment as a state political party officer,[28] a public contractor,[29] a police officer,[30] or a city sanitation worker [31] without a wide range of protections, including procedural due process, the Fifth Amendment right against self-incrimination, and other safeguards.

Although loss of particular employment is a severe sanction, it is not nearly so drastic as total preclusion from a chosen profession.[32] In cases involving exclusion

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[26] 385 U.S. at 285.

[27] 385 U.S. at 285 n.18.

[28] *Lefkowitz* v. *Cunningham*, 431 U.S. 801 (1977).

[29] *Lefkowitz* v. *Turley*, 414 U.S. 70 (1973).

[30] *Gardner* v. *Broderick*, 392 U.S. 273 (1968); *Garrity* v. *New Jersey*, 385 U.S. 493 (1967).

[31] *Uniformed Sanitation Men Ass'n* v. *Commissioner of Sanitation*, 392 U.S. 280 (1968).

[32] *See* Friendly, *Some Kind of Hearing*, 123 U. Pa. L. Rev. 1267, 1297 (1975). Judge Friendly noted that the revocation of a license to practice a profession ranks "high on the pro-

from a profession such as government service[33] or the practice of law,[34] this Court has imposed even higher standards, approaching those applicable in criminal felony trials. In implementing the protections afforded against permanent loss of profession, several federal courts have required "clear and convincing evidence" rather than the "more likely than not" standard advocated by the SEC. For example, where attorneys are subject to disciplinary proceedings, courts have recognized that disciplinary sanctions, even those designed for the protection of the public, severely punish the attorney, often destroying both professional reputation and livelihood.[35] Therefore, proof of the misconduct must be clearly and convincingly shown.[36]

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cedural scale," because "the government is threatening to deprive a person of a way of life to which he has devoted years of preparation and on which he and his family have come to rely," and "the types of issues often resemble those tried in actions for fraud or negligence, or even in criminal proceedings." *Id.* (footnotes omitted).

[33] *United States* v. *Lovett*, 328 U.S. 303 (1946) (Permanent proscription from government service is a "punishment" that can be inflicted lawfully only upon compliance with the Sixth Amendment).

[34] *In re Ruffalo*, 390 U.S. 544 (1968); *Spevack* v. *Klein*, 385 U.S. 511, 514-16 (1967).

[35] *Cf. Kivitz* v. *SEC*, 475 F.2d 956, 962 (D.C. Cir. 1973).

[36] *In re Fisher*, 179 F.2d 361, 369 (7th Cir.), *cert. denied*, 340 U.S. 825 (1950) ("[T]he charges must be sustained by clear and convincing proof") (quoting *In re Donaghy*, 402 Ill. 120, 123, 83 N.E. 2d 560, 562 (1948)); *In re Adriaans*, 28 U.S. App. D.C. 515, 522 (1907). *See In re Ryder*, 263 F. Supp. 360, 361 (E.D. Va.), *aff'd*, 381 F.2d 713 (4th Cir. 1967) ("In proceedings of this kind the charges must be sustained by clear and convincing proof, the misconduct must be fraudulent, intentional and the result of improper motives.").

See also Charlton v. *FTC*, 543 F.2d 903, 906 (D.C. Cir. 1976). In *Charlton*, the court stated that, contrary to the

It is widely acknowledged that SEC disciplinary proceedings are "penal" or "quasi-criminal" in nature.[37] The SEC itself has described them as "closely analogous to proceedings for the collection of a statutory penalty." [38] Judge Friendly has emphasized that SEC disciplinary proceedings have the "quality of visiting serious consequences on past conduct" in characterizing their "penal" aspects.[39] Former SEC General Counsel, now Second Circuit Judge, Timbers labeled SEC disciplinary proceedings "quasi-punitive." [40] A leading commentator has singled out the frequent use of an agency's most severe sanctions as evidence that agency disciplinary proceedings have a "significant penal component." [41] Congress has character-

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FTC's concept, disciplinary proceedings are adversary proceedings of a quasi-criminal nature and disbarment is a punishment or penalty imposed on the lawyer. Although the court spoke of a preponderance standard, it also stated that the case "should be clear and free from doubt." As the court in *Collins* recognized, the *Charlton* court clearly "was referring to the type of clear and convincing evidence long required for discipline of attorneys." 562 F.2d at 825.

[37] Professor Jaffe has noted that the license revocation and suspension powers of administrative agencies are sanctions "far heavier than the ordinary fine" and serve "the functions of a criminal penalty." L. Jaffe, *Judicial Control of Administrative Action* 114 (1965).

[38] *Harold T. White*, 3 S.E.C. 466, 539-40 (1938).

[39] *Arthur Lipper Corp.* v. *SEC*, 547 F.2d 171, 180-81 n.6 (2d Cir. 1976), *cert. denied*, 434 U.S. 1009 (1978).

[40] Timbers & Garfinkel, *Examination of the Commission's Adjudicatory Process: Some Suggestions*, 45 Va. L. Rev. 817, 824 (1959).

[41] L. Jaffe, *Judicial Control of Administrative Action* 267-68 (1965) ("Revocation, indeed, seems often to be used as a sanction not so much to control the respondent as to warn

ized the SEC's sanction of suspending or withdrawing registration as a "draconian remedy." [42] The statutory requirement that the SEC find "willful" violations before exercising its disciplinary powers parallels the criminal scienter standard and serves to underline the "penal" quality of the proceeding.[43]

There is no dispute that the sanction imposed by the SEC against Steadman in this case is a penalty. The court below explicitly so found.[44] The sanction would end Steadman's career and force him to sell his principal asset, his stock in SSC, at a substantial loss. It would permanently bar him from association with any registered investment company and suspend him from association with any broker-dealer for one year. As the court below recognized, "[E]xclusion from the industry is clearly a penalty" that is "indistinguishable in its effect on the respondent from disbarment from the practice of law." [45]

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others, and thus it has a significant 'penal' component, even though the courts may choose to mask its character by calling it a 'civil' remedy.").

[42] S. Rep. No. 75, 94th Cong., 1st Sess. 34 (1975). *See also Hammon Capital Management Corp.*, [1979-80 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 82,449 at 82,891 (Jan. 25, 1980) (initial decision) (revocation of investment adviser's registration "far too draconic" for nonfraudulent violations).

[43] *Cf. Arthur Lipper Corp.* v. *SEC*, 547 F.2d 171, 180-81 nn.6, 7 (2d Cir. 1976), *cert. denied*, 434 U.S. 1009 (1978).

[44] 603 F.2d at 1139.

[45] *Id. See Collins, supra*, 562 F.2d at 825 ("Disbarment or suspension is the equivalent to the penalty imposed on Collins by the SEC here.").

Under the SEC's rationale, as the SEC expressly stated in its decision in this case, *Steadman Security Corp.*, [1977-78 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 81,243 at 88,319-19 n.88 (June 29, 1977), it would also be free to disbar an

The SEC has attempted to justify its preponderance standard by labeling these sanctions "remedial" rather than punitive.[46] The SEC's characterization misses a crucial point.[47] While the SEC may emphasize the remedial component of its disciplinary proceedings, its sanctions—that may deprive the respondent of the profession to which he has devoted a lifetime or impose greater financial sacrifices than the maximum fine for a criminal conviction under the federal securities laws[48]—are dis-

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attorney from practicing before it on the basis of a finding that the attorney had more likely than not committed a willful violation of the federal securities laws. The SEC would thus be in the anomalous position of needing less convincing evidence to deprive an attorney of his chosen professional specialty than would a state or federal judge sitting in a disbarment case.

[46] *See, e.g., Beck* v. *SEC*, 430 F.2d 673, 674 (6th Cir. 1970); *Berko* v. *SEC*, 316 F.2d 137, 141 (2d Cir. 1963); *Blaise D'Antoni & Assoc., Inc.* v. *SEC*, 289 F.2d 276, 277 (5th Cir.), *cert. denied*, 368 U.S. 899 (1961); *Pierce* v. *SEC*, 239 F.2d 160, 163 (9th Cir. 1956).

[47] As the Court noted in *Addington*, what the sanction is called "is less important than that we recognize that it can occur and that it can have a very significant impact on the individual." 441 U.S. at 426.

The SEC's interpretation in its administrative case law of the proper standard is not determinative. As this Court recently emphasized, the existence of a prior administrative practice does not relieve this Court of its responsibility to determine whether that practice is consistent with the SEC's statutory mandate. *SEC* v. *Sloan*, 436 U.S. 103, 117-19 (1978) (rejecting SEC's consistent interpretation, over a 34-year period, of Securities Exchange Act of 1934 provision).

[48] The loss of income resulting from permanent exclusion from the investment advisory business or even a one-year suspension from the brokerage business frequently exceeds the maximum $10,000 fine that can be imposed for the most

tinctly punitive. As the court in *Collins* recognized, "One would hardly say that removal of a criminal from society should be classed as 'remedial' because it protects ordinary citizens from the probable repetition of the crime." [49]

SEC disciplinary proceedings serve the purposes intended by Congress only to the extent that appropriate sanctions are properly and fairly applied. It is not "remedial" to bar from the securities business someone who is erroneously adjudicated guilty of willful fraud. Such a result wrongly deprives the public of a source of investment services,[50] curtails useful economic activity, and undermines industry confidence in regulatory bodies. The clear and convincing standard will thus serve the true purpose underlying the Congressional delegation of disciplinary authority, giving both the SEC and the securities community greater assurance that justice is done.

Greater assurance of justice is particularly important because of the nature of SEC proceedings. Unlike the federal courts in civil and criminal cases, the SEC is investigator, prosecutor, judge, and jury.[51] It does not accord respondents the degree of prehearing discovery avail-

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serious felony conviction under the federal securities statutes. *See, e.g.*, § 24 of the Securities Act of 1933, 15 U.S.C. § 77x (1976); § 32(a) of the Securities Exchange Act of 1934, 15 U.S.C. § 78ff (1976).

[49] 562 F.2d at 825.

[50] One of the principal goals of the Securities Exchange Act of 1934, as amended in 1975, is to promote competition in the securities industry. *See* S. Rep. No. 75, 94th Cong., 1st Sess. 8 (1975).

[51] *See* Schwartz & Wade, *Legal Control of Government* 270 (1972) ("One of the limitations of the administrative expert is his tendency to single-mindedness and excessive zeal. The judges can stand apart from the tensions of the immediate case and mitigate the enthusiasm of the expert by the community's sense of justice.").

able to litigants under the Federal Rules of Civil Procedure.[52] It allows into evidence a potpourri of "proofs" that would ordinarily be inadmissible in a civil or criminal trial pursuant to the Federal Rules of Evidence.[53] The SEC also has a consistent record of aggressive expansion of the scope of the federal securities laws through enforcement proceedings against individual respondents.[54]

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[52] For further discussion, *see* Mathews, *Litigation and Settlement of SEC Administrative Enforcement Proceedings*, 29 Cath. U.L. Rev. 215, 250-53 (1980). *Cf. Villani* v. *New York Stock Exchange*, 348 F. Supp. 1185 (S.D.N.Y. 1972), *modified*, 367 F. Supp. 1124 (S.D.N.Y.), *aff'd on other grounds sub nom. Sloan* v. *New York Stock Exchange*, 489 F.2d 1 (2d Cir. 1973).

[53] *See, e.g.*, Mathews, *Litigation and Settlement of SEC Administrative Enforcement Proceedings*, 29 Cath. U.L. Rev. 215, 258 (1980). Evidence need not even be "competent" to be admissible in SEC disciplinary proceedings. *Clinton Engines Corp.*, 41 S.E.C. 408, 411-12 (1963) (footnotes omitted). For examples of reversals by appellate courts of SEC disciplinary sanctions based upon unreliable evidence, *see, e.g., Kivitz* v. *SEC*, 475 F.2d 956 (D.C. Cir. 1973), *rev'g Murray* v. *Kivitz*, 44 S.E.C. 600 (1971); *Klopp* v. *SEC*, 427 F.2d 455 (6th Cir. 1970), *rev'g Paine, Webber, Jackson & Curtis (Klopp)*, 43 S.E.C. 1042 (1969); *Whitney* v. *SEC*, 604 F.2d 676 (D.C. Cir. 1979).

[54] The SEC both as a party and as *amicus* has, for example, consistently urged this Court to adopt expansive interpretations of the federal securities laws. *See, e.g., Aaron* v. *SEC*, 446 U.S. ——, 48 U.S.L.W. 4609 (U.S. June 2, 1980) (No. 79-66); *SEC* v. *Sloan*, 436 U.S. 103 (1978); *Chiarella* v. *United States*, 445 U.S. ——, 100 S. Ct. 1109 (1980); *Transamerica Mortgage Advisers, Inc.* v. *Lewis*, 444 U.S. 11 (1979); *Touche Ross & Co.* v. *Redington*, 442 U.S. 560 (1979); *International Brotherhood of Teamsters* v. *Daniel*, 439 U.S. 551 (1979); *Piper* v. *Chris-Craft Industries, Inc.*, 430 U.S. 1 (1977); *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185 (1976); *Foremost-McKesson, Inc.* v. *Provident Sec. Co.*, 423 U.S. 232 (1976); *United Housing Foundation, Inc.* v. *Forman*, 421 U.S. 837

It is precisely this type of vigorous enforcement in instances where "administrative procedures are less solicitous of the protection of the individual than are civil or criminal procedures" [55] that calls for the increased procedural protection of a greater standard of proof for administrative agencies "in situations where individuals stand to suffer serious liabilities." [56]

II. THE INTERESTS OF RESPONDENTS IN SEC PROCEEDINGS IN WHICH THEY ARE CHARGED WITH WILLFUL FRAUD REQUIRE THE USE OF THE "CLEAR AND CONVINCING" STANDARD OF PROOF.

In the overwhelming majority of SEC administrative disciplinary proceedings, the SEC alleges willful fraud under the various anti-fraud provisions of the federal securities statutes.[57] In such proceedings, the SEC must make a specific finding that a statutory violation is "willful" in order to impose a sanction.[58]

(1975); *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723 (1975).

[55] Jaffe, *Administrative Law: Burden of Proof and Scope of Review*, 79 Harv. L. Rev. 914, 919-20 (1966).

[56] *Id.*

[57] "In the past decade (1970-1979), the Commission has instituted a total of 864 administrative proceedings in which the order commencing the proceeding alleged violations of one or more of the anti-fraud provisions involved in this case." SEC Brief in Support of Petition for Certiorari at 6 n.8 (April 1980), in the instant case.

[58] *See* Mathews, *Litigation and Settlement of SEC Administrative Enforcement Proceedings*, 29 Cath. U.L. Rev. 215, 238-39 (1980); 2 L. Loss, Securities Regulation 1307-12 (2d ed. 1961); 5 L. Loss, Securities Regulation 3366-77 (2d ed. Supp. 1969).

Willful fraud is a serious charge even when made in a civil or administrative context. An allegation of fraud is considered *per se* defamatory in most jurisdictions.[59] An adjudication of willful fraud stigmatizes the respondent,[60] destroys personal reputation, and frequently causes severe professional and business injury.[61] In the securities industry, SEC proceedings charging willful fraud frequently trigger civil lawsuits in which the SEC's findings may have collateral estoppel effect.[62] This Court has acknowledged the severe consequences of fraud charges, particularly against professionals, in recent securities cases.[63]

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[59] 50 Am. Jur. 2d *Libel and Slander* § 74 (1970); Restatement (Second) of Torts § 569, Comment g (1977). *See, e.g., Reliance Ins. Co.* v. *Barron's*, 442 F. Supp. 1341, 1345 (S.D. N.Y. 1977).

[60] *Whitney* v. *SEC*, 604 F.2d 676, 681 (D.C. Cir. 1979) (Sanctions depending on a finding of fraud "result in stigmatizing the defendant irrespective of the formal sentence meted out.").

[61] *Sea Island Broadcasting Corp.* v. *FCC*, No. 76-1735, slip. op. at 8-9 (D.C. Cir., Jan. 14, 1980).

[62] *See United States* v. *Utah Constr. & Mining Co.*, 384 U.S. 394 (1966); *Shore* v. *Parklane Hosiery Co.*, 565 F.2d 815, 819 n.1 (2d Cir. 1977), *aff'd*, 439 U.S. 322 (1979) ("[W]hen an administrative agency acts in a judicial capacity, collateral estoppel effect may be given to its findings of fact against the respondent rather than require relitigation in subsequent legal proceedings."); Pickholz and Brodsky, *An Assessment of Collateral Estoppel and SEC Enforcement Proceedings After Parklane Hosiery Co.* v. *Shore*, 28 Am. U.L. Rev. 37, 56-58 (1978); Note, *The Collateral Estoppel Effect of Administrative Agency Actions in Federal Civil Litigation*, 46 Geo. Wash. L. Rev. 65 (1977).

[63] *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185, 214-16 n.33 (1976) and *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723, 747-48 (1975), *both quoting Ultramares Corp.* v. *Touche*, 255 N.Y. 170, 174 N.E. 441 (1931).

Because of the gravity of a willful fraud charge the courts have traditionally fashioned special safeguards in fraud cases. Under Rule 9(b) of the Federal Rules of Civil Procedure the circumstances constituting fraud must be "stated with particularity." A finding of fraud must usually be based on a finding of scienter.[64] Most important, many courts,[65] including this one,[66] have insisted that fraud be proved by clear and convincing evidence or "an even higher" standard.[67] As recently as last

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[64] *Aaron, supra,* at 4613-15; *Hochfelder, supra,* at 212-14.

[65] *See, e.g., Borowicz* v. *Chicago Mastic Co.,* 367 F.2d 751, 760 (7th Cir. 1966) ("Fraud is not to be presumed, but must be affirmatively established by clear and convincing proof of each and every essential element."); *Troeder* v. *Lorsch,* 150 F. 710, 714 (1st Cir. 1906) ("[W]hen a person is charged with all the elements which constitute a heinous crime, although it be only on a civil issue, it shocks the judicial mind to refuse to give him the benefit of the usual presumption of innocence unless the adverse proofs are so far satisfactory as to be convincing."). The court noted in *Collins*: "There are literally hundreds of cases decided by the United States Court of Appeals in which the standard applied in fraud situations has been 'clear and convincing evidence.'" 562 F.2d at 824 & n.27.

See C. McCormick, *Evidence* § 340 at 797 (2d ed. 1972); 9 J. Wigmore, *Evidence* § 2498 at 329 (3d ed. 1940). Dean Wigmore states that "some such phrase, as 'clear and convincing proof,' is commonly applied to measure the necessary persuasion for a charge of fraud," and collects the federal and state case law at 329 n.13.

[66] *See Lalone* v. *United States,* 164 U.S. 255, 257 (1896).

[67] *Woodby* v. *INS,* 385 U.S. 276, 285 n.18 (1966) (The clear and convincing "standard, or an even higher one, has traditionally been imposed in cases involving allegations of civil fraud"); *see Collins, supra,* 562 F.2d at 824-26; *Whitney* v. *SEC, supra,* 604 F.2d at 681 n.19 ("We intend the word 'fraud' not merely in its common law sense, but comprehending all violations of § 10(b) and rule 10b-5.").

term, the Court noted approvingly that many jurisdictions reduced "the risk to the defendant of having his reputation tarnished erroneously by increasing the plaintiff's burden of proof" to clear and convincing evidence in fraud cases.[68]

The use of the more exacting "clear and convincing" standard also reflects the belief of the courts that, since proof in cases involving fraud is often circumstantial and dependent on inference, the risk of an error by the trier of fact is particularly great. Basic fairness therefore requires use of the "clear and convincing" standard of proof to offset the enhanced risk of an erroneous result.[69] That securities fraud cases often turn on circumstantial proof is apparent not only from precedent[70] but also from the fact that such cases frequently involve findings with respect to the intentions of businessmen or

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[68] *Addington* v. *Texas*, 441 U.S. 418, 424 (1979).

[69] *See Lalone* v. *United States*, 164 U.S. 255, 257 (1896) ("A mere preponderance of evidence which at the same time is vague or ambiguous is not sufficient to warrant a finding of fraud, and will not sustain a judgment based on such finding."); *Collins, supra*, 562 F.2d at 823; *Whitney, supra*, 604 F.2d at 681 ("[D]espite the presence of some 'direct' testimony in this case, the state of the evidence is hardly unequivocal and we are reluctant to forgo the added assurance of correctness afforded by a heightened standard of proof.").

See also 12 Ga. L. Rev. 153, 154 n.9 (1977):

> The "clear and convincing evidence" standard first appeared in English equity cases involving the use of parol evidence. The courts were concerned about the quality of the evidence; hence, a more stringent standard of proof was adopted. *Townshend (The Marquis)* v. *Strangroom*, 31 Eng. Rep. 1076 (Ch. 1801); *Henkle* v. *Royal Exch. Assurance Co.*, 27 Eng. Rep. 1055 (Ch. 1749).

[70] *See, e.g., Collins, supra; Kivitz* v. *SEC*, 475 F.2d 956 (D.C. Cir. 1973); *Klopp* v. *SEC*, 427 F.2d 455 (6th Cir. 1970).

businesswomen forced to make economic choices under pressure with imperfect information.

The risk of error in SEC disciplinary proceedings in which willful fraud is alleged is heightened by the ambiguity and imprecision of important provisions of the federal securities laws.[71] Several times in the last few years this Court has rejected SEC interpretations of the anti-fraud and related provisions of the securities laws.[72] Several of these decisions suggest that the meaning of fraud may be particularly unclear in the securities context.[73] In such circumstances, the "clear and convincing" standard of proof affords an essential protection against an erroneous finding of willful fraud and the attendant stigma.

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[71] *See Collins, supra,* 562 F.2d at 822-23. *See* 12 Ga. L. Rev. 153, 157 n.24 (1977): "The [*Collins*] court noted that the practice of relying on inferential evidence is unobjectionable and is a result of the ambiguities and imprecisions of the securities laws."

[72] *See* cases cited at note 54, *supra.*

[73] The fiduciary nature of the standards of conduct imposed on investment advisers under the Investment Advisers Act, *SEC* v. *Capital Gains Research Bureau,* 375 U.S. 180 (1963), is not a reason for a lesser standard of proof under that statute. First, federal fiduciary responsibility law is, if anything, even more ambiguous than securities fraud law. Second, the clear and convincing standard has been required in an adjudication of willful fraud charges against a broadcasting licensee who is a statutory trustee with a special fiduciary duty to the public. *Sea Island Broadcasting Corp.* v. *FCC,* No. 76-1735 (D.C. Cir., Jan. 14, 1980). In any event, the Investment Advisers Act violation was but one of the violations upon which the SEC based its sanctions against Steadman. Among others, the SEC found willful violations of the anti-fraud provisions of § 17(a) of the Securities Act of 1933 and § 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder.

III. ALTHOUGH THE COURT OF APPEALS CORRECTLY REQUIRED THE SEC TO JUSTIFY THE PARTICULAR SANCTIONS IT IMPOSES, THIS REQUIREMENT IS NOT A SUBSTITUTE FOR CLEAR AND CONVINCING EVIDENCE OF A WILLFUL VIOLATION.

In ordering the SEC to satisfy the "burden of justification" by articulating the reasons for choosing the precise sanction ultimately imposed on petitioner and in suggesting the range of factors the SEC might appropriately employ, the Fifth Circuit neither announced a new doctrine nor established additional procedural safeguards for respondents in SEC disciplinary proceedings. Rather the court merely engaged in traditional judicial review of final agency action by insisting on the first prerequisite of judicial review, an explanation of how the agency reached its decision.[74] Under the authority of the Administrative Procedure Act, 5 U.S.C. §§ 551(10), 551 (13), 702, 706 (1976), and the due process clause, numerous courts have reviewed and on occasion modified disciplinary sanctions imposed by the SEC.[75] The Court of Appeals neither purported to expand the law nor in fact did so.

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[74] *See Citizens to Preserve Overton Park* v. *Volpe*, 401 U.S. 402 (1971); *Nassar & Co.* v. *SEC*, 566 F.2d 790, 794 (D.C. Cir. 1977) (in remanding case, court emphasized need for specific factual findings supporting SEC's revocation order); *Beck* v. *SEC*, 413 F.2d 832, 834 (6th Cir. 1969), *after remand*, 430 F.2d 673, 675 (6th Cir. 1970) (court remanded case to SEC with instructions to disclose reasons for imposition of suspension order; after remand, court set aside four-month supervision order as a "gross abuse of the Commission's remedial authority").

[75] *E.g.*, *Arthur Lipper Corp.* v. *SEC*, 547 F.2d 171, 184-85 (2d Cir. 1976), *cert. denied*, 434 U.S. 1009 (1978) (modifying severe broker-dealer revocation and bar order found to constitute an abuse of discretion); *Beck* v. *SEC*, 430 F.2d 673, 675 (6th Cir. 1970). *See* note 53, *supra*.

The Fifth Circuit decision should not be read to imply that the SEC's duty to explain its exercise of discretion in selecting particular sanctions is a substitute for "clear and convincing" proof that a willful fraud violation had occurred. Although the court did state that a high standard of proof to establish a willful violation is not "the only means to protect a respondent," [76] it nowhere suggested that it viewed different procedural protections as interchangeable or that its views about the proper standard of proof did not stand on their own merits. Indeed, the Court of Appeals did not even suggest that the SEC should consider whether its willful fraud finding was supported by clear and convincing evidence or only a mere preponderance of the evidence in choosing a sanction.

Nor should the long-standing and unexceptionable requirement that the SEC engage in a reasoned exercise of discretion in selecting sanctions substitute for clear and convincing evidence of a violation. First, the selection of a penalty proceeds from the premise that a willful violation has occurred. If that premise is erroneous—or if a respondent in an SEC disciplinary proceeding has to bear an unfair risk that it is erroneous—the unfairness of the entire disciplinary proceeding cannot be cured by the introduction of safeguards during the penalty phase of the proceedings.

A mere finding that a respondent has engaged in willful fraud has serious adverse consequences.[77] These consequences do not disappear with a subsequent administrative determination not to impose the most severe available sanction. Regardless of the choice of sanction, any unfairness in the underlying adjudication of willful fraud is ineradicable and will have direct, demonstrable, and deleterious effects upon the party unfairly tainted.

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[76] 603 F.2d at 1139.

[77] *See* text at notes 59-63, *supra*.

Branding the respondent as a willful fraud violator[78] may trigger private, and sometimes vexatious,[79] civil litigation in which the willful fraud finding may have a collateral estoppel effect.

Second, reliance solely on appropriate justification of the sanction will encourage the SEC to initiate proceedings on the basis of marginal evidence since the SEC will be able to justify a public censure even where the evidence establishes only that it is barely more likely than not that a willful violation occurred. Given the risks and expenses of litigation, adoption of the Fifth Circuit's approach is likely to enable the SEC to extract settlements from respondents who might otherwise not even be the targets of disciplinary proceedings.[80]

Third, the notion that a critically important procedural safeguard should depend upon the severity of the sanction actually imposed rather than the potential sanction at the outset of the proceeding is inconsistent with principles enunciated by this Court in other situations. For example, this Court has looked to the maximum authorized penalty in distinguishing between serious crimes and petty offenses for purposes of the Sixth Amendment right to jury trial.[81]

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[78] *See, e.g., Whitney, supra,* 604 F.2d at 684 (The record did not support the SEC's characterization of "petitioner as an ingenious schemer, deliberately spreading misimpressions and confusion.").

[79] *See Blue Chip Stamps* v. *Manor Drug Stores,* 421 U.S. 723, 739-44 (1975).

[80] *See, e.g.,* H. Kripke, *The SEC and Corporate Disclosure: Regulation in Search of a Purpose* 47-51 (1979); *Parklane Hosiery Co.* v. *Shore,* 439 U.S. 322, 355-56 (1979) (Rehnquist, J., dissenting).

[81] *See Codispotti* v. *Pennsylvania,* 418 U.S. 506, 511 (1974); *Baldwin* v. *New York,* 399 U.S. 66, 68 (1970); *Frank* v. *United States,* 395 U.S. 147, 149 (1969) ("[T]he severity of

Finally, the Fifth Circuit was quite careful to point out the modest degree of protection that is afforded by judicial review of the SEC's choice of sanction.[82] In light of such narrow review, the requirement that the SEC justify its choice of sanction is no substitute for the protection afforded by insisting that the trier of fact find clear and convincing evidence of willful fraud.

CONCLUSION

Respondents in SEC administrative disciplinary proceedings have important personal and professional "interests at stake . . . more substantial than mere loss of money." *Addington* v. *Texas*, 441 U.S. 418, 424 (1979). As this Court pointed out in *Addington*, "[T]he ultimate truth as to how the standards of proof affect decision-making may well be unknowable. . . . Nonetheless, even if the particular standard-of-proof catchwords do not always make a great difference in a particular case, adopting a 'standard of proof is more than an empty semantic exercise.' " [83]

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the penalty authorized, not the penalty actually imposed, is the relevant criterion."); *Duncan* v. *Louisiana*, 391 U.S. 145, 159 (1968) ("[T]he penalty authorized for a particular crime is of major relevance in determining whether it is serious or not and may in itself, if severe enough, subject the trial to the mandates of the Sixth Amendment.").

[82] 603 F.2d at 1139-40. *See Butz* v. *Glover Livestock Commission Co.*, 411 U.S. 182, 185 (1973) (citing *American Power Co.* v. *SEC*, 329 U.S. 90, 112 (1946)).

[83] 441 U.S. at 424-25 (citing *Tippett* v. *Maryland*, 436 F.2d 1153, 1166 (4th Cir. 1971) (Sobeloff, J., concurring in part and dissenting in part), *cert. dismissed sub nom. Murel* v. *Baltimore City Criminal Court*, 407 U.S. 355 (1972)). *See also In re Winship*, 397 U.S. 358, 369-70 (1970) (Harlan, J., concurring). *Cf.* Underwood, *The Thumb on the Scales of Justice: Burdens of Persuasion in Criminal Cases*, 86 Yale L. J. 1299, 1311 (1977).

Amicus SIA respectfully suggests that clear and convincing evidence of willful fraud is essential in SEC disciplinary proceedings to balance the risks of erroneous decisions that are detrimental to society at large, as well as to industry professionals who make up the pool of prospective respondents in SEC administrative disciplinary proceedings. The mere preponderance standard does not satisfy society's demands of procedural fairness to individuals whose personal and professional reputations and livelihoods are at stake.

For the reasons set forth above, the decision of the Court of Appeals should be reversed insofar as it held that the SEC may find a willful violation of the antifraud provisions of the federal securities laws based on a mere preponderence of the evidence, and affirmed insofar as it required the SEC to justify with particularity the sanction it chooses to impose.

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